

**The Mechanics' Lien Act:
Time for Repeal?**

Discussion Paper

**Law Reform Branch
Office of the Attorney General
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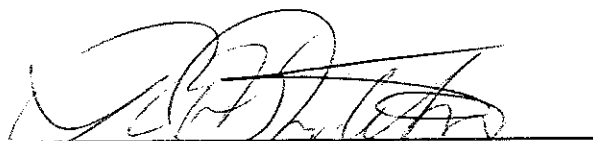
FOREWORD

The aim of this paper is to provoke discussion as to whether New Brunswick's Mechanics' Lien Act should be repealed. The Law Reform Branch suggests that it should be. However, before any firm recommendation is made to the Government, we would like to hear the views of others.

The proposals set forth in the discussion paper are tentative and do not represent policy of the Department of Justice or the Government. They are offered for consideration and reaction. All representations received will be considered before a final report is prepared for presentation to the Minister.

Those wishing to make representations are invited to do so by November 1st, 1992. Communications should be directed to the office of the

Director
Law Reform Branch
Office of the Attorney General
P. O. Box 6000
Fredericton, NB
E3B 5H1



~~Basil D. Stapleton, Q.C.~~
Director

TABLE OF CONTENTS

Introduction	1
The Holdback Problem	7
Possible Solutions	9
Option 1: Repeal of the Act	9
Option 2: Improved Observance of the Act	33
Option 3: Create Exceptions	34
Option 4: Re-Structure the Lien/Holdback Tandem	38
Option 5: Make the Act an Opt-in Scheme	43
Conclusion	46

THE MECHANICS' LIEN ACT: TIME FOR REPEAL?

Introduction

This paper asks two questions. First, should the Mechanics' Lien Act be repealed? Second, if it should not, what should be done about the holdback provisions, particularly as they affect consumers with little or no knowledge of their statutory obligations? There are, of course, many other questions that could be asked about the Mechanics' Lien Act, and in responses to this paper we would welcome comments on other aspects of the Act as well. The more limited focus set out above, however, is accounted for by the way in which our research has developed to its present stage.

Our study began in response to representations from the Ombudsman, who, in 1985, investigated complaints from householders and accepted their view that the Act caused injustice. The difficulty the Ombudsman described was in terms of the householders' lack of notice of the existence of mechanics' liens. This seemed at first sight a small problem which ought to respond to a small solution. As our study progressed, however, the question of whether the Mechanics' Lien Act should continue to exist loomed ever larger into view. Protecting uninformed householders turned out to be

difficult within the framework of the Act. To do so involved undermining other interests that the Act promotes, but as we examined the alternatives we found, first, that we were not sure why those other interests demanded special legislative protection, particularly given what we could discover about the implementation of the Act in practice, and second, that we were doubtful that, even for those it was supposed to protect, the Mechanics' Lien Act was anything more than a decidedly mixed blessing. Our research has therefore reached the stage at which we need input from other sources. Our provisional view is that, on balance, the Mechanics' Lien Act does at least as much harm as good, and should be repealed. If others agree, our efforts can end at this point.

If they disagree, however, the question of the uninformed householder re-emerges as requiring attention. The later pages of this paper examine some possible approaches. These are offered for comment in their own right, but also in the context of our question about a possible repeal of the Act. If the Act in its present form is worth preserving, would it still be worth preserving once it had been amended to give protection to the uninformed householder? Similar questions may arise in relation to other problems with the Mechanics' Lien Act that people may bring to our attention. If additional issues are raised it would be helpful if people would indicate whether they see them as further items in support of repeal of

the Act or as items that could and should be corrected within the general framework of the Act. In the latter case, suggested solutions would be appreciated.

We should say that, over the course of our study, we have come to regard the consumer protection issue as an increasingly fundamental one. The Mechanics' Lien Act already only applies to part of the operations of the construction industry: the Act does not bind the Crown, and highway construction for municipalities is specifically excluded. We are told that these exceptions represent a major part of the total of construction activity in New Brunswick. We assume that contracts involving householders may represent a significant portion of what is left, though the size of most individual contracts may be small. If this is so, changes in relation to householders may substantially alter the scope of the Act.

Changes in relation to householders, however, seem to be absolutely warranted. The information that we have suggests that among householders the Mechanics' Lien Act is not widely known about, and that even those who do know about it often disregard it, sometimes willingly, sometimes under what they might regard as duress. The Act is also capable of causing injustice when it is applied. The case for change, though, rests less on the actual occurrence of injustice, which we are inclined to believe is relatively infrequent, than on the very large gap that we believe exists between conduct and the law.

Even in relation to construction work that does not involve householders, we suspect from our reading of the New Brunswick case-law that an equally large gap between conduct and the law may often exist. Several of the cases could not have developed as they did unless, even in the commercial sector, much business is conducted as though the Act did not exist, the Act being little more than a possible afterthought if things go wrong. That the law should be an afterthought, of course, is not unusual. It is probably normal that people do not pay attention to their legal remedies until they need them. What is different about the Mechanics' Lien Act as an afterthought, though, is that when it is invoked in cases in which it has not been specifically borne in mind as work progressed, it imposes a set of legal rights and obligations which is probably quite different from the assumptions under which the people involved have been operating. It does so, moreover, with the equivalent of a retroactive effect, since parties will discover that actions like retaining holdbacks are things that they should have been doing since times long past. In such circumstances the Act becomes more a trap for the unwary than a protection for the worthy. It may well be that there are comparatively few instances in which it is formally invoked by implementation of the measures set out in the Act. This, though, is not a strong point in favour of the Act. Rather, we are inclined to view it as an indication that, for the most part, life would go on after repeal of the Act much as before. All we would be repealing are rules which people normally do not follow.

There are, of course, some people who take the Mechanics' Lien Act seriously. However, our impression is that these are the people for whom the law serves the least purpose: they are the people who have the legal and financial resources to take care of their own interests, and would do so even if the Act were not present. Indeed, by use of such devices as bonding these people evidently do bargain for protection beyond that given by the statute. Conversely, the people who are arguably most in need of statutory protection -- employees, whose livelihood depends on the contracts and the solvency of others -- seem to make virtually no use of the Act. In our research for this paper we have examined twenty-five years of reported cases in New Brunswick; we have identified only one in which the lien claimed was for wages. We have also briefly reviewed all mechanics' liens filed in 1990 and 1991 in the three registry offices within easy range of Fredericton: York County, Sunbury County and Queen's County. No liens for wages were filed. The only thing that came close was one claim for lien filed by a union in relation to payments that were to be made directly to the union under a collective agreement. The payments were in respect of members' benefit packages. The judge decided that the lien was in fact a lien for wages (contrary to the lienor's submission), but even so this is clearly not a case in which employees asserted their rights under the Act. Any benefit they received was through their association with an organization -- the union --

which fits the description above of having the financial and legal resources to look after its interests. Employees acting alone, we believe, get virtually no benefit from the Act.

What all of this amounts to is that we suspect that the Mechanics' Lien Act is a failure: that it simply does not do what it sets out to do. Its failure, moreover, comes at a price. One aspect of this is the potential for injustice that arises in circumstances like those of the domestic construction contracts, where practice bears so little relationship to the law. Another is the economic cost of complying with the legislation. The point is often made that mechanics' lien legislation adds cost to construction projects by slowing the flow of funds; the suggestion is that the Act may be a hindrance to economic activity rather than a help. Some degree of hindrance, no doubt, might be acceptable as a small price to pay for increased security. Our suspicion, however, is that any increase in security is minimal and is more than outweighed by the costs and inconvenience that the Act imposes.

Our tentative view, then, is that the Act should be repealed. We say this despite recognizing in the Mechanics' Lien Act some elements that, in the abstract, have appeal. The idea that those whose labour and materials create an object for another person have some kind of vested interest in that object until they are paid has some attraction. In this respect the Mechanics' Lien Act bears comparison with things like the

developing common law notion of the constructive trust (which, we believe, if the Act were repealed, might well substitute for it in certain circumstances). Similarly, if the Mechanics' Lien Act were viewed, as in some lights it can be, as an attempt to ensure that the money available to fund an undertaking finds its way to the people who need it most, it might be seen as legislation to be developed, even expanded, rather than abandoned. Our present suggestion, then, that the legislation should be repealed without replacement reflects the view that whatever promise the legislation may show in worthwhile directions such as these, it fails to deliver. On balance, we suggest, New Brunswick would be better off without it.

The Holdback Problem

As mentioned above, the specific problem which was referred to us for study concerned the effect of the holdback provisions of the Act on consumers who have little or no knowledge of their rights and duties under the Act. At first sight it may seem surprising that this apparently well-defined issue should have developed into an inquiry as to whether the Act should be repealed. However, the holdback provisions are central to the Act. As the Act now stands, they are the essential counterpart to the existence of the lien that the Act creates. The lien gives everybody involved in a construction project a direct right against the owner of the property on

which the construction is taking place. The holdback provides the protection against the exercise of the right. Mechanics' lien legislation, it is said, is based upon the idea that construction projects typically involve a chain of contracts, with many of the parties involved having no contractual rights against many of the others in the chain. In this context, the lien provides a means by which people lower in the chain are given a measure of protection against the misconduct of those higher up. The holdback performs the opposite function, that of protecting the owner from people lower down in the chain of contracts. It provides a fund out of which liens can be satisfied, at least partially, while not exposing the owner to the double jeopardy of paying both the contractor and the lienholder for the same work.

In practice, however, as is exemplified by the problem that the Ombudsman referred to the Department of Justice, there is every reason to believe that this nice tandem of lien and holdback does not work. Ordinary householders, it is said, often do not know of the possibility of a lien being placed on their property, nor of the obligation to hold back a percentage of the price. They therefore pay the builder in full, and experience in full the double jeopardy when the lienholder subsequently calls for satisfaction of the lien. It is suggested, furthermore, that even the householder who does know about the scope and effect of the Mechanics' Lien Act may find it difficult or disadvantageous to comply. Builders may be

unwilling or unable to wait for payment until the holdback period expires, and may require payment in full if work is to proceed. The smooth operation of the contract will often depend upon each party being able to make accommodations to the needs of the other. Again, therefore, the double jeopardy of the householder arises: the lien will exist, but the holdback fund will not.

The indications that we have are that, at least at the small-scale, domestic level, and probably more widely, the requirements of the Mechanics' Lien Act are frequently not followed, whether knowingly or unknowingly, whether willingly or reluctantly. If this is so, it is surely a reflection on the inadequacy of the Act. If, in relation to what we believe is probably the majority of cases to which it applies, construction work proceeds despite the law being ignored -- or possibly only because it is ignored -- and if injustice is considered to result when an unpaid third party, by enforcing the lien, does exactly what the law provides for, something is evidently wrong with the law. The task then is to decide what to do about it.

Possible Solutions

Option 1: Repeal the Act

The solution that we particularly want to canvass here

is repeal of the Act. Obviously, this is a more comprehensive step than would be necessary if one were merely trying to protect consumers, but protecting consumers is harder than one might think under the existing statutory framework. Repealing the Act would certainly remove the risk that consumers are now exposed to. It would also mean that there would be no need to resolve any other problems that people may bring to our attention in response to this paper. If, on the other hand, the Act is not repealed, the form in which it is retained should be one that relieves consumers from the risk that the Act now poses. We describe later the kinds of amendments that we have considered, and we are open to suggestions of others. We hope that those who oppose repeal of the Act, if there are any, will not only give their reasons but will also tell us what their preferred approach would be to the problem of the consumer. One question they will need to address is whether the Mechanics' Lien Act could be amended in accordance with their preferred option for consumers yet still serve a useful purpose.

There are two major sources for our provisional view that the Mechanics' Lien Act should be repealed. One relates to the case for the Act in principle, the other to the question of whether it is effective in achieving its ostensible goals. Our doubts on these two accounts interrelate.

In terms of the underlying principle of the Act, the first difficulty that we encounter is that we have not yet discovered an authoritative or persuasive statement of what that underlying principle is. There are, of course, many explanations, in judgments, textbooks, law reform commission reports and elsewhere. The explanations differ, though. The Act is sometimes viewed as an attempt to boost the construction industry and promote construction activity; sometimes it is presented as an attempt to protect the economically vulnerable in a notoriously insecure occupation. Some explanations are expressed in terms of debt collection, with the Mechanics' Lien Act put virtually in the framework of insolvency law. On other occasions the Act is justified on the basis that legal relationships involved in the construction industry are special and demand special treatment. Each of these descriptions no doubt has some validity: one can at least read the Act and see the logical connection. Nonetheless, their variety does lead one to wonder how much faith to place in any of them. The more elaborate they become, the more they smack of rationalization rather than explanation.

This uncertainty as to what the Mechanics' Lien Act is really intended to accomplish increases when one examines the proceedings of the Legislative Assembly when the Act was first put in place. The government of the day was obviously not enthusiastic. It introduced the legislation as a government measure for the first time in 1894, having previously opposed

it on more than one occasion when introduced as a private member's Bill. In the debates in 1893 A. G. Blair, Premier and Attorney General, had spoken against the Bill:

Hon. Mr. Blair said that he would support the Bill if it could be shown that its passage would not be an injury to other classes. He argued at length to show that the Bill would give a monopoly to wealthy contractors and that it really gave no protection to the labourers or mechanics. (Synoptic Reports, 1893, p.120)

A century later, that argument still has the ring of truth.

When the Bill was introduced the following year, it was Mr. Blair who introduced it, though with obvious reservations.

Mr. Blair said that this was the first time such a Bill had been introduced as a government measure. It was being submitted in consequence of a very strong desire entertained throughout the country and after a careful consideration of the working of similar laws elsewhere. While personally friendly to the principles of liens he was free to say that he had always entertained doubts as to whether the principle could be worked out so as to avoid serious injury to innocent parties. (Synoptic Reports, 1894, p.126)

The government, in short, appears to have acted against its better judgment in introducing the Bill, and the reference to the Bill being submitted "in consequence of a very strong desire entertained throughout the country" causes one to look

with some interest at the comment made by the Chairman of the South Australia Law Reform Committee to the Newfoundland Law Reform Commission in response to the latter's 1988 Working Paper on mechanics' liens. He wrote that mechanics' lien legislation was "the legal 'flavour of the month,' so to speak" in Australia in the 1890's, but that all States except South Australia had subsequently repealed their legislation. Insofar as any rationale for the New Brunswick Act emerges from the debates of 1893 and 1894 in the Legislature, it would be that the legislation was to advance the cause of liens in general -- a broad constructive trust or 'sweat equity' kind of notion -- rather than construction liens in particular. The fact that the legislation was restricted to the construction context appears to have been accepted as a negative rather than a positive feature, one that detracted from the broader merits of the legislation rather than promoting them. Certainly the debates cannot support the argument that the legislation was a deliberate response to the special requirements of construction work -- a fact which tends to reinforce the failure of subsequent arguments in support of the Act to carry conviction.

As to the social need for the legislation at the time in New Brunswick, we note that it took fourteen years before the first mechanics' lien was registered in Sunbury county and twenty-eight years in Queen's county. These are both rural counties. In York county, which includes Fredericton, one

claim for lien was filed in 1894, three in 1895, none in 1896 and one in 1897. Evidently there was no great rush to take advantage of the Act.

If one is perplexed, then, by the question of what the Mechanics' Lien Act was really intended to accomplish, one can at least respond to the argument that the special legal structures in the Act are a response to the special legal circumstances in the construction industry. Texts on mechanics' liens mention the pyramid-like structure of construction contracts, with general contractors, sub-contractors, suppliers, and so on, all joined together in a common enterprise leading to the production of an improvement on a landowner's land. They mention that the improvement is made on credit, and that there is a need to ensure that those who contribute to the improvement are paid. They note that many of the parties in the pyramid are not linked by privity of contract, and therefore may lack the ability to enforce their rights against many of the other participants.

None of this, frankly, is very convincing. The pyramid-like structure, for example, is not exclusive to construction contracts. Many other manufacturing processes depend on sub-contracts and supplies of parts. Some may even be comparable in scale to major construction projects: large shipbuilding contracts spring to mind as an example that has relevance in New Brunswick, and the paper-making machine

described in Beloit Canada Ltd v Fundy Forest Industries Ltd (1981) 37 N.B.R. (2d) 17 was certainly not a minor piece of equipment: 200 feet long, 18-20 feet high, 15-16 feet wide, and installed as an integral part of a paper mill that was being constructed, it was still not considered as an "improvement" coming within the scope of the Act's preferential treatment.

We suspect, furthermore, that the complexity of major contracts, which descriptions of the kind given above seem to conjure up, is probably not matched by the facts of most of the contracts to which New Brunswick's Mechanics' Lien Act applies. This is especially likely to be so if it is true, as has been suggested to us, that in this province most major construction projects are either Crown projects or highway projects, to neither of which does the Mechanics' Lien Act apply in full. A survey of claims for lien filed in York, Sunbury and Queen's counties in 1991 certainly suggests that there is nothing complicated about most of the situations in which mechanics' liens are filed. In almost 40% of the cases, the lienors were evidently dealing with owners directly and exclusively; no one else is named on the claim for lien as being involved. A further 10% or so of the lienors were dealing directly with tenants in relation to tenants' improvements in shopping malls. In other cases it seemed as though, had the point been argued, the contractor might well have been held to be acting as agent for the owner in buying

supplies or arranging for work to be done. Cases in which the lienor was acting at more than one contractual remove from the owner were extremely rare. Admittedly, even with simple contractual structures such as these, there can be a gap in privity between the owner and, say, the contractor's employee or the supplier with whom the contractor deals. There is nothing complex or extraordinary about these contracts, though. They have their counterparts in numerous other fields beside construction. We are not sure what it is about construction work which would call for a special legal regime. If the legislation is designed to cater for complex 'pyramids' of the kind described in the literature, we suggest that for New Brunswick, it is based on a false premise. Most of the contracts to which New Brunswick's Act applies, we believe, are just not like that.

The suggestion that the improvement on the owner's land is created on credit is also a strange element in a justification of the legislation. Extending credit, in the sense of allowing time to pay, is an ordinary feature of many commercial activities, but in the case of the Mechanics' Lien Act, an extension of credit of that sort is required by the legislation itself, which obliges the owner to retain the 15% or 20% holdback out of all payments until 60 days after the work is substantially completed. In current circumstances, moreover, one would surmise that the credit on which most improvements are substantially constructed is credit in a more

conventional sense, that provided by financial institutions. This might be advanced to the landowner or to any of the entities working on a project, and might or might not be secured. If the Mechanics' Lien Act truly has anything to do with protecting those who extend the credit which permits a landowner to receive the benefit of an improvement on land, there seems little reason to limit the Act to those who do the work or provide the materials. One of the benefits sometimes claimed for mechanics' lien legislation is that it encourages construction activity by facilitating the supply of credit to the construction industry. If this is so, it is certainly anomalous, for if there is one thing that the mechanics' lien legislation certainly does, it is weaken the position of the financier.

What, then, of privity and ensuring that people get paid? In many cases there is no need to supplement the law on privity of contract. If there is enough money to satisfy all claims, it will make little difference whether this is done through a mechanics' lien action or through a series of actions following lines of privity. Interestingly, in approximately half of the reported cases decided in New Brunswick under the Mechanics' Lien Act in the last 25 years, the competing parties were bound to each other contractually. Whatever else the Act may have done in those cases, it was certainly not overcoming any absence of privity. Even more surprising, in only 25% of the cases was there an obvious financial hurdle to overcome,

with the Act being used so that a plaintiff could reach beyond an insolvent defendant, and proceed against one who could satisfy the claim. In fully half of the cases there was no financial problem - the relevant parties were apparently solvent and present. In the other quarter, there was no indication one way or another. This is not to deny that there are cases in which the Act establishes chains of liability that could not have been put together through a series of claims in contract. Nonetheless, judging from 25 years of reported cases, situations in which the Act is necessary to the plaintiff's success are rarer than one might think.

Can the Mechanics' Lien Act, then, legitimately be presented, as is sometimes done, as legislation favouring the 'little guy' in the world of construction? In form, perhaps, that may be possible, especially given the special priority that the Act allows for the lien for wages. In practice, however, we doubt that it can be shown to have much of a tendency in this direction.

'Little guys', we believe, probably come in two forms: employees, who are vulnerable to the fate of their employer and are not in privity with anyone else, and small businesses for whom a particular contract represents the principal source of its income for the period covered by the contract.

From the material we have examined, we see little indication that the Mechanics' Lien Act is of much benefit to employees. As mentioned above, in the 25 years of case-law we have examined, we see only one case in which the lien claimed has obviously been a lien for wages. In two years of filings in the York, Sunbury and Queen's County registry offices there are no liens for wages claimed. The only one that comes close is the lien filed by the union which had members working on a shopping mall development, where the lien related to payments which were directly due to the union under a collective agreement.

Small business is better represented both in the case law and in the liens filed, but even so it is a minor player. Who is, and who is not, a small business is not always easy to identify from the names listed in the mechanics' lien register, but local knowledge of firms in the Fredericton area does at least make a number of businesses recognizable as not being small. These account for some 2/3 of the claims filed, leaving small business as responsible for, at most, the remaining 1/3. Clearly, small business is not the major user of the Act. Possibly the Mechanics' Lien Act may have some slight attraction as a debt collection mechanism (though one can never be sure that the debts would not have been paid equally quickly under other collection methods), but there is certainly nothing that we see in the case-law or in our survey of liens filed to

indicate that the 'little guys' in the construction business, be they employees or small business, would be significantly more vulnerable to non-payment if the Act were repealed.

This leads to the broader question of whether the Mechanics' Lien Act is successful in ensuring that contributors to the construction process, whether 'little' or large, are paid. It is at this point that our reservations about the merits of the Act move from questioning its underlying principles to questioning its effectiveness. At this stage, we are prepared to assume for the sake of the argument that the Act represents a justified attempt to give preferential treatment to the construction industry. The question then is whether the Act is successful in delivering the security which, ostensibly, it aims to do.

The answer must be that it is not. This is not to deny that the Act provides some litigants with benefits which, in the absence of the Act, would have gone elsewhere: clearly, the Act does produce some winners. It also produces losers, though, and very often it is hard to know in advance who the winners and losers will be. As often as not, mechanics' lien actions revolve around internecine strife between construction creditors, the result being to favour some over others, and often there is no competing non-construction creditor to be ousted under the legislation. When we say, therefore, that the Act does not provide the security that is sometimes claimed for

it, we are using that word in the sense of reliability or predictability. Reading the case-law with the benefit of hindsight, one can normally understand the processes by which the litigation produces the results it does. These, however, are often so hard to foretell before the judge speaks, and so little within the control of the people involved, that it is hard to see that anyone could confidently conduct business on the basis that the Act would provide protection if things went wrong.

The Act provides four kinds of security to people involved in creating an improvement on an owner's land: the trust of project money under s.3, the lien under s.4, the charge on the holdback under s.15 and the right to require an additional holdback under s.16. As to the last two items on this list, all one can really say is that their usefulness is not apparent from the case-law, in which they figure rarely. In relation to the additional holdback under s.16, we have heard the comment that people are scared to use it, fearing that it may do more harm than good if a construction project is financially shaky. In relation to the charge on the holdback, it seems that it is probably of little value for two reasons: first, because the Act does not direct a specific sum of money to be set aside as representing the holdback, and in the absence of this, the charge often becomes, as security, indistinguishable from the lien and the credit-worthiness of the owner; second, because even where a specific holdback fund

is available, sub-contractors only have access to it to the extent that it is attributable to their sub-contract. Thus in R. A. Corbett & Co. Ltd v Phillips (1973) 5 N.B.R. (2d) 499, where a sub-contractor abandoned a project at a time when the owner still retained more than \$47,000 in holdback, creditors of the sub-contractor only had access to the holdback to the extent of \$2,640, this being the portion of the holdback attributable to the contract between the contractor and the sub-contractor.

The security that figures most prominently in cases under the Mechanics' Lien Act is, naturally enough, the lien itself. As a substantial source of security, however, it has serious limitations. It is short-lasting. Though it arises by operation of law when work is first done, it expires 60 days after substantial completion unless, during that period, steps are taken to enforce it. The temporary nature of the lien is presumably the explanation for the noticeably high proportion of mechanics' lien cases that revolve around procedural issues. If actions can be struck out for failure to file an affidavit of verification, register a lis pendens, or whatever, the lien will be gone because the time within which the action must be brought will have expired. Cases on the procedural aspects of the legislation rarely bear the stamp of a statutory scheme effectively securing the interests of those it is supposedly created to protect.

Another thing that the Mechanics' Lien Act seems to do is complicate disagreements that arise during the construction process. It has already been mentioned that most of the reported mechanics' lien cases are in fact disputes between parties who are in privity of contract. They take place in the context of the Mechanics' Lien Act because the Act is there, and because, superficially at least, it offers plaintiffs an advantage that it would be foolhardy to pass up. In some cases the litigation may only take place because of the legislation, perhaps because a contractor or sub-contractor, needing to file within 60 days of substantial completion, files the claim for lien, and thereby brings everything to a halt. MacArthur's Paving and Construction Co. Ltd. v. New Era Enterprises Ltd. (1989) 102 N.B.R. (2d) 412 seems to be a case of this general nature. Two construction contracts overlapped in relation to certain property, and though the holdback fund was apparently adequate to satisfy all claims, liens were filed and the two competing lien claimants became embroiled in a complicated dispute over their respective priority. In cases like Grannan Plumbing and Heating Ltd. v. Simpson Construction (1979) 24 N.B.R. (2d) 238, the main contribution of the Mechanics' Lien Act seems to have been to complicate immeasurably a dispute that should have been relatively straightforward. In substance all that seems to have been involved was a dispute between a contractor and a plumbing sub-contractor as to who was responsible for some excavation work that needed to be done. What it became, though, when the contractor withheld from the

plumber the cost of the excavation work, was a lien action which pulled in the owner and the bonding company as well, and then revolved around the question of whether the owner could take the benefit of a waiver of lien provision which was contained in the plumber's contract with the contractor, but was not contained in the contract between the contractor and the owner. The result was complicated litigation, and a complete distortion of what was apparently a perfectly straightforward disagreement.

Complications of the kind described above arise from the administrative aspects of the mechanics' lien system. Others arise from its substance. The idea of 'substantial completion', for example, which is a major feature of the legislation, is also a major source of practical uncertainties. Liens can only be filed within 60 days of substantial completion, and after that the holdback can be distributed, but when does substantial completion occur? Builders can obviously be caught by the fact that time can begin to run when there is still work to be done (e.g. Hub City Renovations Ltd. v. Budd (1988) 94 N.B.R. (2d) 69), and in a case like W. A. C. Excavators v Food City Ltd (1986) 71 N.B.R. (2d) 186 the owner and the builder may both turn out to be mistaken as to when work is substantially completed, with the court holding that it was later than the owner thought, but earlier than the sub-contractor thought. Both parties are then at risk, depending on when, by reference to a date on which

neither believes the contract 'substantially completed', the sub-contractor happens to file the claim of lien. In W. A. C. Excavators an additional question was whether the sub-contractor had filed within 60 days of the expiry of a period of credit. In the context of the informal contractual relationship under which the sub-contractor was working, the court was not satisfied that a period of credit had been agreed. The result was that the lien vanished and the plaintiff remained unpaid.

Rights under the Mechanics' Lien Act also come to depend, at times, on minute and artificial analyses of contractual dealings. The sort of issue that arises is whether, over the course of a building project, an electrical contractor does several separate jobs or one job in several instalments (see e.g. Eddy Hardware (1971) Ltd. v. Keystone Development Co. Ltd. (1975) 13 N.B.R. (2d) 451). The decision on that issue will determine whether the parties are dealing with one lien, for one amount, with one date for substantial completion, or a number of liens, with separate amounts and different dates for substantial completion. Given the need to file within 60 days, the alternative analyses produce very different results. Investigations of this sort are hardly a credit to a legal framework supposedly designed to ensuring that contractors and sub-contractors get paid. Sometimes they will, sometimes they will not, but certainly it is hard to see that the legislation can give them much reason for a sense of security.

Another feature of the legislation that must cast doubt on the extent to which people can sensibly place reliance on it is that whether or not a person is protected by the legislation is frequently determined by events beyond that person's control. When, for example, a supplier provides materials to a sub-contractor, whether the supplier has a lien depends on whether the materials are provided for a project involving a particular owner. Thus arrangements between the sub-contractor and the supplier, details of which the owner may well not know, will determine whether the owner's property is to be bound. Likewise, the supplier may not know whether he or she has a lien. The materials supplied may be definitely intended for a particular project, but in some cases it will be necessary to prove that they did in fact become incorporated in the building, an eventuality over which the supplier has no control once he or she has parted with the goods. A case like Brunswick Construction Ltée v. Michaud (1979) 26 N.B.R. (2d) 55 shows that a supplier may supply materials to a sub-contractor with the specific intent that they be used on a particular project, but that the prospective claim for lien vanishes if the sub-contractor mingles those materials with others. Even delivering materials direct to a contract site will not assure the supplier of the protection of the lien. This may be because the contractor happens to use specific materials to construct equipment rather than the structure of a building (e. g. Dobbelstyn Electric Ltd v Whittaker Textiles (Marysville) Ltd (1976) 14 N.B.R. (2d) 584) or because the

materials, though used during the construction process and useless thereafter, do not eventually remain on site as part of the completed building (e.g. wood used to build forms for pouring a basement, but then removed from the site - R. A. Corbett & Co. Ltd v Phillips (1972) N.B.R. (2d) 499). Often, however, it may be a matter of mere chance whether particular materials from a particular supplier end up by being incorporated in a building.

It seems equally unlikely that suppliers, sub-contractors and so forth would have any detailed information as to the state of the financing of a project under a mortgage. This matters because under s.9(2), a prior mortgage has priority over liens, "but only to the extent that the total of all payments or advances made . . . does not exceed the value of the land at the time that payment or advance is made." This provision affected the lienholders in a case like Dobbelstyn Electric Ltd v Whittaker Textiles (Marysville) Ltd (1976) 14 N.B.R. (2d) 584. The case arose out of a factory renovation that ran into financial difficulties. The renovation had been financed by the New Brunswick Industrial Finance Board, who had promised \$1,500,000 under a debenture which gave, among other things, a fixed and specific mortgage and charge. There was first an argument as to whether this debenture was a "conveyance, mortgage or other charge," since if it was not, it would not attract priority. It was held that it was. On this basis, the Board had priority to the extent of the value of the

land when its advances were made, which was determined to be some \$987,000. The lienholders, one would assume, are unlikely to have had the faintest idea of the state of the mortgage or of the value of the land at any time, though these were vital elements in relation to their security.

Upping the ante in the Dobbelstyn case, there was also the position of the Workers' Compensation Board. The Board was a judgment creditor of the defendant in respect of the unpaid balance of the latter's assessment. On the WCB's position Stevenson J. said this:

The combined effect of section 72 of the Workmen's Compensation Act and section 51 of the Property Act is to give the Workmen's Compensation Board a lien upon the defendant's property ranking after the security held by the Industrial Finance Board but ahead of the successful lien claimants.

With the Industrial Finance Board ranking partly before and partly after the lienholders, though, the WCB's position was uncertain. Stevenson J. held that, if the NBIFB had advanced no more than \$987,000, the WCB ranked ahead of the lienholders, but if the NBIFB had advanced more than \$987,000 the WCB would be entirely postponed to the lienholders. Here again one sees the protection offered by the Act to the lienholders depending on facts they could not know and could not control. Certainly, one can see the impact of the Act, after the event, in re-ordering priorities and determining who gets paid. What is

hard to see, though, is that the result is sufficiently predictable that any of the parties could really have done anything much in actual reliance on the supposed security of the Act.

The last of the major elements of protection that the Mechanics' Lien Act gives is the trust under s.3. An analysis of the trust is similar in many ways to an analysis of the lien itself. In abstract terms, and on the assumption that special protection for building contracts is desirable, the trust arguably has some attraction; the idea that funds flowing through the project are to be held and used for paying the people involved is a nice match for the 'pyramid' concept in terms of which the Mechanics' Lien Act is often explained. The difficulties, however, come at the practical level. Here again, as with the lien, there is reason to question both the protection that the trust gives and whether it does so with enough predictability to be of significant comfort to anyone. The trust provisions have not produced a large amount of litigation in New Brunswick, so the discussion can be brief.

As to the degree of protection that the trust gives, a major factor is that the holder of the funds has the discretion to decide how to apply the funds, as between the various lawful applications available. The beneficiaries of the trust therefore do not have equal protection, since the holder of the funds can decide which ones will get the money, and can even

decide to pay its own expenses first (Fundy Ventilation Ltd. v. Brunswick Construction Ltd. (1982) 40 N.B.R. (2d) 484).

As for the unpredictability of the trust, many of its features match those of the lien. For example, the supplier of materials is only a beneficiary of the trust if the supply is so specifically directed to a particular contract that the lien arises: Re Johnson Construction (1983) 52 N.B.R. (2d) 219. Suppliers may therefore be unaware of whether they are protected. As with the lien, they may lose their protection because of events over which they have no control.

The holders of the trust funds are apparently placed in a particularly uncomfortable position. They may be unaware of who the potential beneficiaries are, and they are at risk of diverting trust funds when they cannot even know whether trust obligations still exist. Additional exposure arises from the fact that the trust endures even after the time for filing claims of lien is gone. A case like Harding Carpets Ltd. v. Saint John Tile & Terrazzo Co. Ltd. (1988) 87 N.B.R. (2d) 427 is a case in point. Here the plaintiff, long after delivering carpet to the Hilton Hotel development in Saint John (note the tenuous connection between supplying carpet and the 'sweat equity' principle of mechanics' lien law), claimed in trust against the party which was three steps above it in the chain of contracts, and two down from the owner. The plaintiff had already got judgment against the party with whom it had direct

contractual dealings, but had failed to recover on the judgment. It had not registered a claim for lien. The defendant no longer had the trust fund money, but was still held liable for making an unauthorized use of the money at a time when Harding Carpets had not been paid. In the actual circumstances of the case, one might possibly feel that no great wrong was done to the defendant. The use made of the money was to set off a separate debt between the defendant sub-contractor and the contractor, and these were two related companies. Small variations of the facts, though, might have produced very different results, with a sub-contractor held liable for paying to a third party money that the sub-contractor thought was profit on the contract, possibly unaware even of the existence of a supplier, let alone of the fact that the supplier had not been paid. In a case like Fundy Ventilation Ltd. v. Brunswick Construction Ltd. (1982) 40 N.B.R. (2d) 484, it is hard not to sympathise with the plight of Brunswick Construction Ltd., the statutory trustee and eventual loser of the case. There the owner, Fraser Companies Ltd, agreed with Brunswick Construction Ltd., the contractor on a \$91 million contract relating to a sulphite mill in Edmundston, that substantial completion had occurred earlier than the court eventually determined. The owner paid the contractor, and the contractor, out of money owed to the sub-contractor, paid an income tax demand under a third party notice which related to tax owed by the sub-contractor. The balance of the sub-contractor's bill was paid jointly to the

sub-contractor and the plaintiff, who had been engaged by the sub-contractor to provide the ventilation system. The plaintiff liened, and the owner then claimed that Brunswick was liable to it under the trust. The plaintiff also claimed directly against Brunswick under the trust. Both claims were successful. In a case like this, one certainly sees the loss being redistributed under the trust provision. What one does not see, though, is any convincing reason of why it is right that the loss should be redistributed in the way it is.

The above is not intended as a comprehensive critique of the Mechanics' Lien Act -- far from it. Rather, it is intended as a brief description of why we are unconvinced of the value of the legislation. Our reservations are on two accounts: first, because we see no compelling argument for the existence of a legal regime of this sort, restricted to the construction industry; second, because even if we were persuaded on the first point, we could not see the legislation as being effective in doing what it is ostensibly designed to do. Our reservations on both accounts are now brought to a head by the concerns expressed to us about the position of the uninformed householder. We examine below various means of addressing the problem, but each of them seems to involve changes which would have a major impact on the scope and operation of the legislation. If, therefore, the Mechanics' Lien Act is of any real value, we see the protection of consumers as being

problematic. If, on the other hand, the Act serves little real purpose or does, on balance, more harm than good, the best way forward would be to repeal it. We invite comment.

Option 2: Improved Observance of the Act

As mentioned above, repealing the Mechanics' Lien Act is a more comprehensive step than is necessary if all one is trying to do is respond to the consumer protection issue that was originally referred to us. If, then, contrary to our present inclinations, the Act is to be retained, how might one respond to the consumer problem within the context of the Act?

One possibility is to improve observance of the Act: to change conduct so that it matches the law rather than to change the law so that it conforms with the conduct. Part of this approach would be to improve people's knowledge of the Act. To the extent that the source of the problem outlined above is that householders are not aware of the requirements of the law, the obvious response would be to cure their ignorance. Alternative methods might include a general campaign of public information, or imposing on somebody (most likely the builder) some form of specific obligation to notify the householder of the effect of the Act.

The weakness of this approach is that experience appears to suggest that the Act is not followed, even when people are

aware of its requirements. There seems to be little point in going to great lengths to inform people of what the Act says if they are still going to disregard it. If, as we suspect, the root of the problem is that the requirements of the Act simply do not reflect the practicalities of the vast majority of the situations to which it applies, no additional amount of information is likely to have much effect.

Does the answer, then, lie in improved enforcement, in finding some better means of obliging people to act as the Act says they should? Again, the answer depends partly on whether the Mechanics' Lien Act is a practical piece of legislation. If it is not, there is little point in investing time and effort in trying to bring people to comply with it: the effort will not succeed. If, moreover, there is doubt as to whether the legislation is desirable in principle, why would one wish to compel compliance with it? Unless and until we are convinced that the Act provides a better legal framework for the subject-matter it regulates than would exist if the Act were not there, it is hard for us to accept that achieving improved observance of the Act should be the objective of legislative reform.

Option 3: Create Exceptions

The next group of possibilities revolve around creating exceptions to the Act. These would provide protection for

those who are now most at risk from the Act. Given that the practical concern expressed relates to ordinary householders, the most obvious exception would be a 'householder exception'. An alternative might be a 'financial exception', stating that the Act only applies to contracts above a certain amount.

A. A 'Householder Exception'. The general idea of a 'householder exception' would be to protect ordinary consumers who were simply having work done to their residences. Obviously the exact nature of the exception would need careful delineation. One important decision would be whether the exception should be limited to improvements to existing dwellings, or whether it should also extend to new construction for would-be resident owners. Arguably, those who were having a complete new house built could be expected to take greater care as to the surrounding legal context.

The first problem with this approach is that, whatever the wording of the definitions, there would be uncertainty in some cases as to whether the Act applied. This would be undesirable, but is the price one inevitably pays for creating exceptions. More fundamentally, though, it is hard to see that, given the principles of the Act, it makes any difference whether what is being worked on is a residence or anything else. Construction is construction, and even a small pyramid of contracts is still a pyramid of contracts. In practical terms, moreover, adopting a 'householder exception' would raise

the question of whether the Act continued to achieve anything substantial once the 'exception' was cut away. Given the existing limits of the Act in relation to highway construction and Crown projects, if a 'householder exception' were also introduced, would the remaining scope of the Act be worth saving?

B. A 'Financial Exception'. A financial exception would be designed to keep small projects out of the scope of the Act. There is an analogy in the existing rule that no claim of lien can be filed if the total amount involved is less than \$100 (s.4(4)).

Obviously, the effect of an exception for projects that were small in financial terms would depend upon the level at which a project was defined as 'small'. Given that the purpose of the amendment would be to protect the consumer/householder, 'smallness' could be expected to be defined by reference to the dollar amount involved in normal consumer construction contracts. Again, the figure would be different depending on whether it was assessed by reference to renovations or to new construction.

One advantage of a financial exception is that it recognizes that the scale of a construction project, and thus the complexity of the contractual relationships it may generate, does not depend on whether it is residential or

commercial. Thus if the contractual complexity of construction contracts is the justification for the Mechanics' Lien Act, a financial test may well be a more suitable key to it. On the other hand, as a means of protecting consumers, the 'financial exception' suffers from the weakness of doing indirectly what a 'householder exception' would do directly; it therefore risks failing to protect some of the people it would be designed for (householders would not be protected if their residential work was expensive) and protecting some people it was not designed for (non-domestic owners would be protected if their building project happened to be inexpensive). It also suffers from the difficulty, particularly from the lienholders' point of view, that the same figure in dollars may mean different things to different people. For some, \$5,000 may be nothing; for others, it may be everything. If, then, one accepts for the sake of argument that the Mechanics' Lien Act genuinely gives protection to those in the construction business who need it, the danger in establishing a financial exception would be that it might remove the protection from those who need it most. The higher the limit was set, the more the Act would become a vehicle for giving a legal advantage to large contractors only. It is hard to see this as a desirable objective, particularly since the large contractors' continuing legal advantage would now be at the expense of the smaller contractors. The latter, when working under 'small' contracts, would be numbered among the general creditors over whom the lien claimants would take priority.

In addition, of course, the question again arises of whether the Act would be worth saving in the face of such an exception. If a financial exception is established, with the dollar amount set at a level to reflect the idea that, up to a reasonable amount, people should be able to have work done without being affected by the Mechanics' Lien Act, are we not cutting out a large proportion of the contracts to which the Act now applies? And if we are, is the Act worth keeping solely to regulate what is left?

Option 4: Re-structure the Lien/Holdback Tandem

The problem that we started with has been termed that of double jeopardy: that the householder, having paid the contract price once to the builder, may then have to pay the lien amount to a lienholder, and may lose the property if he/she is unable to pay. One way of avoiding this would be to revise the existing legal incidents of the lien and the holdback.

A. Full Payment as Satisfaction of the Lien. An obvious possibility is to say that full payment by the owner to the builder under the contract discharges the lien. This, however, undermines a major principle of the Act, which is that the security of those who work on a construction contract is against the owner's land. If the lien were discharged by full payment, that security would be gone. Admittedly, the lien is

not their only security. Section 3 also imposes a trust fund for contract money, and allowing full payment to discharge the lien would not affect the trust obligations of the contractor and subcontractors. Nonetheless, insofar as the lien and the holdback give protection against what may happen to the trust money once it is in the hands of those to whom it is paid, that protection would be lost.

Another effect of allowing full payment to discharge the lien, even during the holdback period, would probably be to produce a significant change in the practices based on the Act. Applied across the board, it would be tantamount to repealing the holdback provision: with the lien discharged by payment, the threat that holdbacks guard against would be gone. This could be expected to affect those aspects of construction contracts that now revolve around the statutory holdback amounts and holdback periods. Indeed, allowing payment in full to discharge the lien, however early the payment was made, could even produce an incentive for early payment under the contract, since early payment would enable the risk of being liened to be removed at the earliest possible opportunity.

No doubt there could be ways of giving a degree of protection for early payments while not undermining the holdback system entirely. An obvious example would be to say that only payments made in ignorance of the law discharged the

lien. Arguably, in the interests of consumer protection, one should go further, since it is not always ignorance of the law that is the cause of the risk. However, anything that might be developed along these lines runs into a familiar obstacle. It would make the protection of the suppliers, employees and so forth depend on things which would be hard for them to know and impossible for them to control. It would add, therefore, one further element to the unpredictabilities of an Act which, as discussed above, already seems to us to be defective on account of its unpredictability.

B. A Simplified Act. Extending the line of reasoning in the paragraphs above, one thing we have wondered is whether there is anything to be said for a reformulated Mechanics' Lien Act, stripped down to its basic principles and rid of much of the detail which now clutters the legislation. If one simply created in the Act a statutory lien, which was not time-limited but could be protected at any time by registration or discharged by full payment to the contractor, and a statutory trust such as now exists, one could perhaps produce an Act that was far simpler than the existing one yet perhaps as effective in achieving its legal aims.

We say this, though, with an awareness of the considerable practical implications that would flow from an attempt to re-cast the Act in this simpler form. Some were mentioned under the previous heading, and might produce

substantial changes of practice in those areas of construction work where the Mechanics' Lien Act is now taken seriously. We also have considerable reservations as to whether that 'simpler' result would actually be attainable. Experience suggests that it is easy enough to formulate the broad general principles of legislative reforms, but that when one gets down to the details of the legislation, simplicity can be elusive. The existing trust provision of the New Brunswick Act is a case in point. It is, in a sense, simple. It is certainly short, and it expresses its basic idea in straightforward terms. In application, however, it is far from simple, and can be, as described above, a source of considerable uncertainty and risk for anybody who happens to be in possession of trust funds. Ontario has abandoned such a sweeping provision in favour of a more limited one. The Newfoundland Law Reform Commission has argued in favour of the more limited provision. Things are not always as 'simple' as they seem.

C. Make the Lien/Holdback Contingent on Notice. At present, the lien arises as a matter of law as from the day work begins, and the obligation to hold back applies whenever a payment under the contract is made. It is this which makes ignorance of, or non-compliance with, the Act such a problem. If the lien did not arise until the owner had been notified, and then only related to work or materials subsequently provided and payments subsequently made, the problems would be cured. The

giving of notice would serve to inform the owner of the requirements of the Act, and the owner would presumably comply, since he/she has nothing to lose by doing so.

Two major difficulties arise from this approach. First, if the Mechanics' Lien Act does provide protection that is of value, imposing a notice requirement would undermine it. If protection is needed, it is presumably needed from day one. The change discussed here would probably only begin to provide protection once it was already too late. Though notice could be given before the work began, one suspects that in practice it would often only be given after things had started to go wrong.

The second drawback of this approach emerges when one asks who, among the various parties who may be involved in a construction project, would have the power to serve the notices. Amendments of this sort might say that only the head contractor could serve the notice on the owner, or they might say that any participant in the project could. In the first case, this would give the head contractor a veto over the applicability of the Act, and the head contractor could not be relied on to act in the interests of all whom the Act aims to protect. In the second case, it would allow any participant to impose the holdback on all others, whether they liked it or not. Each approach has its problems.

A third possibility would be somehow to limit the notice so that it only affected the specific interest of the party giving the notice. This, though, is essentially the function of s.16 already. If this were considered the route to follow, it would lead in the direction of repealing the automatic holdback provision in s.15, the implications of which have been touched on above. We note also that s.16 does not appear to be a particularly useful section at present, and that it is hard to see that a provision along the lines of s.16 can be drafted so as not to have at least some effect on other participants in the contract. This is because compliance with the notice could presumably only be by deductions from payments that would otherwise have been made to the head contractor, and through him/her, to other participants. Again, therefore, the party serving the notice would to some extent be imposing a new legal regime on the other parties to the project and disrupting the anticipated flow of the project.

Option 5: Make the Act an Opt-in Scheme

At present it is possible to contract out of the Mechanics' Lien Act, but only to the extent the Act permits. If the Act became an opt-in scheme, it would only apply if the parties expressly agreed that it did. This would solve not only the problem of the uninformed consumer but also that of the recalcitrant contractor. The owner who opted in would

presumably know what he or she was getting into, and the contractor who opted in would presumably be prepared to operate in accordance with the Act.

If one limits one's attention to the position of the owner and the contractor, an opting in system has some attractions. It would mean that the parties were free to follow the scheme of the Act or not as they wished. Whether they chose to do so would presumably depend upon whether they thought the Act provided satisfactorily for the relationships of the various participants in a construction project.

The problem with an opting in approach comes when one considers the position of participants other than the owner and the head contractor, particularly employees or people who only become involved at later stages of the project. The alternatives here are similar to those discussed earlier with the notice provision. Either the other participant has no say in whether the Act applies, or he/she has the right to impose the Act on others, or some middle way has to be found by which some sort of partial application of the Act can be effected. Under the first of these alternatives, people are at the mercy of the owner and the contractor, who cannot necessarily be expected to act in any interests but their own. Under the second alternative, the owner and the contractor, and possibly others as well, are at the mercy of anybody else who happens to

think that the Mechanics' Lien Act should be imposed on them all. Under the third alternative, the prospects are of an extremely complicated legal situation.

Of these alternatives, the first seems the most practical: that the head contract would determine whether or not the Act applied. As to the effect on people who were not parties to that contract, one answer might be that they would not have to become involved with the project or the contractor if they were uncomfortable with the terms on which the project was being conducted. If disquiet at the idea that the Mechanics' Lien Act might not apply were sufficiently widespread, this would presumably influence the head contractors and lead them to opt in as a matter of course. Making the Act an opt-in scheme, therefore, would expose the particular set of legal relationships imposed by the Mechanics' Lien Act a hundred years ago to the test of reality today. It would, in effect, give those who are now covered by the Act a choice as to whether or not it should survive. If they regularly chose to opt in, or only to participate in projects that were being conducted under the Act, the Mechanics' Lien Act would remain a living reality. If they did not, the Act would become in practice a dead letter, and could be repealed in due course.

Conclusion

At present, it is not clear to us whether the Mechanics' Lien Act should continue to be part of the laws of this Province. With this issue unresolved, it is equally difficult to know how to approach the consumer protection problem referred to us by the Ombudsman. As to the Act itself, we have a variety of reservations, such that on the material available to us we are doubtful that the Act achieves much that is worth accomplishing. We hope that others will give us the benefit of their experience on this. In relation to the consumer problem that we started with, we suspect that the various solutions we have discussed may either make a bad Act worse or may so limit the scope of the Act that it might as well be repealed.

We therefore lean at present towards the view that the Act should be repealed. Alternatively, if this seems too absolute a step to be made at this time, we would suggest making the Act an opt-in scheme, thus exposing the Act to the test of reality in the 1990's. Experience under an opting-in provision could be reviewed after a period of time to see whether repeal or some other form of amendment was justified. We are not inclined at present to recommend an overhaul and reworking of the Act. We doubt that this would produce an Act that worked much better than the present one, but in any event we consider that before such an exercise is even contemplated,

there is an onus of justification to be overcome by those, if any, who would wish to see the Act continue. If, contrary to our present belief, the Mechanics' Lien Act does provide a significant advantage to specific groups, what is the justification for that advantage and for its preservation?

